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SUMMARY OF CASES
RELATING TO
FARMERS' COOPERATIVE ASSOCIATIONS

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LIABILITY OF COOPERATIVE ASSOCIATIONS FOR PAYMENT OF
FEDERAL "SOCIAL SECURITY" TAXES

This article has been prepared with a view to assisting those who may be called upon to counsel cooperative associations in connection with their possible liability for payment of taxes, commonly called Federal Social Security taxes, under the Federal Insurance Contributions Act and the Federal Unemployment Tax Act. A principal objective has been to present an article confined to material which is believed to relate rather directly to the operations of farmers' cooperative associations.

The original Social Security Act was approved August 14, 1935. For old-age benefits, title VIII thereof imposed an excise tax on certain employers and an income tax on certain employees, measured by wages paid and received after December 31, 1936, with respect to employment after that date. Title IX (unemployment tax) of the original act imposed an excise tax on certain employers measured by wages payable with respect to employment performed during the calendar year 1936 and subsequent calendar years. Both titles VIII and IX of the original act have, however, been superseded.

The Federal Insurance Contributions Act, as amended, which is subchapter A (26 U.S.C. 1400-1432) of chapter 9 of the Internal Revenue Code has replaced title VIII; and the Federal Unemployment Tax Act, as amended, subchapter C (26 U.S.C. 1600-1611) of chapter 9 of the Internal Revenue Code, has replaced title IX.

WITHOUT EXCEPTION, COOPERATIVE ASSOCIATIONS INCURRED LIABILITY FOR THE TAXES IMPOSED UNDER THE AFOREMENTIONED PROVISIONS OF LAW WITH RESPECT TO WAGES FOR ALL SERVICES RENDERED BY ALL THEIR EMPLOYEES BETWEEN THE EFFECTIVE DATES THEREOF AND JANUARY 1, 1940.

COOPERATIVE ASSOCIATIONS SHOULD NEVER ASSUME THAT BECAUSE THEY ARE EXEMPT FROM THE PAYMENT OF FEDERAL INCOME TAXES THEY ARE BY VIRTUE THEREOF ALSO EXEMPT FROM THE PAYMENT OF "SOCIAL SECURITY" TAXES.

COOPERATIVE ASSOCIATIONS ARE NOW LIABLE, EXCEPT UNDER LIMITED AND SPECIAL CIRCUMSTANCES, FOR PAYMENT OF THE TAXES IMPOSED UPON EMPLOYERS BY THE FEDERAL INSURANCE CONTRIBUTIONS ACT, AS AMENDED, AND BY THE FEDERAL UNEMPLOYMENT TAX ACT, AS AMENDED, WITH RESPECT TO WAGES FOR SERVICES RENDERED AFTER DECEMBER 31, 1939. It is the purpose of this article to seek and consider the limited and special circumstances under which some cooperative associations may not be liable, in whole or in part. Except that the tax imposed by the Federal Unemployment Tax Act applies only to employers (of eight or more employees), as defined in that act, the position of cooperative association employers appears to be substantially the same under both acts. For convenience and brevity, therefore, our consideration is hereinafter generally

confined to the limited and special circumstances under which some cooperative association employers may not be liable, in whole or in part, for the payment of taxes imposed by the Federal Insurance Contributions Act, for old-age benefits.

Inasmuch as section 1410 of the Federal Insurance Contributions Act, which imposes the tax, fixes the amount as equal to specified percentages of the wages paid with respect to employment, it becomes of primary importance to examine section 1426(b) of the Act for a definition of the term employment. Subsection (b) of section 1426 is in part as follows:

"(b) Employment. -- The term 'employment' means . . . any service, . . . performed . . . by an employee for the person employing him, . . . except --

(1) Agricultural labor (as defined in subsection (h) of this section)."

The definition of agricultural labor, taken from subsection (h) of section 1426, is in part as follows:

"(h) Agricultural Labor. -- The term 'agricultural labor' includes all services performed --

(1) On a farm, in the employ of any person, in connection with cultivating the soil, or in connection with raising or harvesting any agricultural or horticultural commodity, including the raising, shearing, feeding, caring for, training, and management of livestock, bees, poultry, and fur-bearing animals and wildlife.

(2) . . .

(3) In connection with the production or harvesting of maple sirup or maple sugar or any commodity defined as an agricultural commodity in section 15 (g) of the Agricultural Marketing Act, as amended, or in connection with the raising or harvesting of mushrooms, or in connection with the hatching of poultry, or in connection with the ginning of cotton, or in connection with the operation or maintenance of ditches, canals, reservoirs, or waterways used exclusively for supplying and storing water for farming purposes.

(4) In handling, planting, drying, packing, packaging, processing, freezing, grading, storing, or delivering to storage or to market or to a carrier for transportation to market, any agricultural or horticultural commodity; but only if such service is performed as an incident to ordinary farming operations or, in the case of fruits and vegetables, as an incident

to the preparation of such fruits or vegetables for market. The provisions of this paragraph shall not be deemed to be applicable with respect to service performed in connection with commercial canning or commercial freezing or in connection with any agricultural or horticultural commodity after its delivery to a terminal market for distribution for consumption."

Section 1429 of the act directs the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, to make and publish rules and regulations for the enforcement of the act. The current regulations* has the following to say with respect to agricultural labor:

"Sec. 402.208. Agricultural labor. --

"(a) In general. -- Services performed by an employee for the person employing him which constitute 'agricultural labor' as defined in section 1426(h) of the Act are excepted. The term as so defined includes services of the character described in paragrapha (b), (c), (d), and (e) of this section.

In general, however, the term does not include services performed in connection with forestry, lumbering, or landscaping.

"(b) Services described in section 1426(h)(1) of the Act. -- Services performed on a farm by an employee of any person in connection with any of the following activities are excepted as agricultural labor:

(1) The cultivation of the soil;

(2) The raising, shearing, feeding, caring for, training, or management of livestock, bees, poultry, fur-bearing animals, or wildlife; or

(3) The raising or harvesting of any other agricultural or horticultural commodity.

The term 'farm' as used in this and succeeding paragraphs of this section includes stock, dairy, poultry, fruit, fur-bearing animals, and truck farms, plantations, ranches, nurseries, ranges, orchards, and such greenhouses and other similar structures as are used primarily for the raising of agricultural or horticultural commodities. Greenhouses and other similar structures used primarily for other purposes (for example, display, storage, and fabrication of wreaths, corsages, and bouquets), do not constitute 'farms.'

* Regulations 106, U.S. Treasury Department, Bureau of Internal Revenue.

"(c) . . .

"(d) Services described in section 1426(h)(3) of the Act. -- Services performed by an employee in the employ of any person in connection with any of the following operations are excepted as agricultural labor without regard to the place where such services are performed:

(1) The ginning of cotton;

(2) The hatching of poultry;

(3) The raising or harvesting of mushrooms;

(4) The operation or maintenance of ditches, canals, reservoirs, or waterways used exclusively for supplying or storing water for farming purposes;

(5) The production or harvesting of maple sap or the processing of maple sap into maple sirup or maple sugar (but not the subsequent blending or other processing of such sirup or sugar with other products); or

(6) The production or harvesting of crude gum (oleoresin) from a living tree or the processing of such crude gum into gum spirits of turpentine and gum rosin, provided such processing is carried on by the original producer of such crude gum.

"(e) Services described in section 1426(h)(4) of the Act. --

(1) Services performed by an employee in the employ of . . . a farmers' cooperative organization or group in the handling, planting, drying, packing, packaging, processing, freezing, grading, storing, or delivering to storage or to market or to a carrier for transportation to market, of any agricultural or horticultural commodity, other than fruits and vegetables (see subparagraph (2), below), produced by . . . farmer-members of such organization or group of farmers are excepted, provided such services are performed as an incident to ordinary farming operations.

Generally services are performed 'as an incident to ordinary farming operations' within the meaning of this paragraph if they are services of the character ordinarily performed by the employees of a farmer or of a farmers' cooperative organization or group as a prerequisite to the marketing, in its unmanufactured state, of any agricultural or horticultural commodity produced by such farmer or by the members of such farmers' organization or group. Services performed by employees of such . . . farmers' organization or group in the handling,

planting, drying, packing, packaging, processing, freezing, grading, storing, or delivering to storage or to market or to a carrier for transportation to market, of commodities produced by persons other than such . . . members of such farmers' organization or group are not performed 'as an incident to ordinary farming operations'. [Underscoring added.]

(2) Services performed by an employee in the employ of any person in the handling, planting, drying, packing, packaging, processing, freezing, grading, storing, or delivering to storage or to market or to a carrier for transportation to market, of fruits and vegetables, whether or not of a perishable nature, are excepted as agricultural labor, provided such services are performed as an incident to the preparation of such fruits and vegetables for market. For example, if services in the sorting, grading, or storing of fruits, or in the cleaning of beans, are performed as an incident to their preparation for market, such services may be excepted whether performed in the employ of a farmer, a farmers' cooperative, or a commercial handler of such commodities.

(3) The services described in subparagraphs (1) and (2), above, do not include services performed in connection with commercial canning or commercial freezing or in connection with any commodity after its delivery to a terminal market for distribution for consumption. Moreover, since the excepted services described in such subparagraphs must be rendered in the actual handling, planting, drying, packing, packaging, processing, freezing, grading, storing, or delivering to storage or to market or to a carrier for transportation to market, of the commodity, such services do not, for example, include services performed as stenographers, bookkeepers, clerks, and other office employees, even though such services may be in connection with such activities. . . [Underscoring added.]

Subsection (b) of section 1426 of the act also contains the following:

"(b) Employment. -- The term 'employment' means . . . any service, . . . performed . . . by an employee for the person employing him, . . . except --

. . .

(10)

(A) Service performed in any calendar quarter in the employ of any organization exempt from income tax under section 101, if --

(i) The remuneration for such service does not exceed \$45, . . .

(ii) . . . , or

(iii) such service is performed by a student who is enrolled and is regularly attending classes at a school, college, or university."

If, therefore, a cooperative association or a corporation organized by such an association is exempt from payment of Federal income taxes under subsections (12) or (13) of section 101 of the Internal Revenue Code, it appears that services performed for such an organization, within the limitations of (10)(A)(i) and (iii), quoted above, of section 1426(b) are not included within the term "employment." Section 402.217 of the regulations has the following to say with respect to the effect of section 1426(b)(10)(A) of the act:

"Sec. 402.217. Organizations exempt from income tax. --

"(a) In general. -- This section deals with the exception of services performed in the employ of certain organizations exempt from income tax under section 101 of the Internal Revenue Code. If the services meet the tests set forth in paragraph (b), (c), or (d), such services are excepted.

. . .

"(b) Remuneration not in excess of \$45 for calendar quarter. -- Services performed by an employee in a calendar quarter in the employ of an organization exempt from income tax under section 101 of the Internal Revenue Code are excepted, if the remuneration for the services does not exceed \$45. The exception applies separately with respect to each organization for which the employee renders services in a calendar quarter. A calendar quarter is a period of three calendar months ending on March 31, June 30, September 30, or December 31. The type of services performed by the employee and the place where the services are performed are immaterial; the statutory tests are the character of the organization in whose employ the services are performed and the amount of the remuneration for services performed by the employee in the calendar quarter.

. . .

"(c) . . .

"(d) Students employed by organizations exempt from income tax. -- Services performed in the employ of an organization exempt from income tax under section 101 of the Internal Revenue Code by a student who is enrolled and is regularly attending classes at

a school, college, or university, are excepted. For purposes of this paragraph, the amount of remuneration for services performed by the employee in the calendar quarter, the type of services, and the place where such services are performed are immaterial; the statutory tests are the character of the organization in whose employ the services are performed and the status of the employee as a student enrolled and regularly attending classes at a school, college, or university.

The term "school, college, or university" within the meaning of this exception is to be taken in its commonly or generally accepted sense."

Another pertinent part of the act is subsection (c), of section 1426, as follows:

"(c) Included and Excluded Service. -- If the services performed during one-half or more of any pay period by an employee for the person employing him constitute employment, all the services of such employee for such period shall be deemed to be employment; but if the services performed during more than one-half of any such pay period by an employee for the person employing him do not constitute employment, then none of the services of such employee for such period shall be deemed to be employment. As used in this subsection the term 'pay period' means a period (of not more than thirty-one consecutive days) for which a payment of remuneration is ordinarily made to the employee by the person employing him. . . ."

The preceding subsection is explained in the regulations, section 402.207, in the following manner:

"Sec. 402.207. Included and excluded services. -- If a portion of the services performed by an employee for the person employing him during a pay period constitutes employment, and the remainder does not constitute employment, all the services of the employee during the period shall for purposes of the tax be treated alike, that is, either all as included or all as excluded. The time during which the employee performs services which under section 1426(b) of the Act constitute employment, and the time during which he performs services which under such section do not constitute employment, within the pay period, determine whether all the services during the pay period shall be deemed to be included or excluded.

"If one-half or more of the employee's time in the employ of a particular person in a pay period is spent in performing services which constitute employment, then all the services of that employee for that person in that pay period shall be deemed to be employment.

"If less than one-half of the employee's time in the employ of a particular person in a pay period is spent in performing services which constitute employment, then none of the services of that employee for that person in that pay period shall be deemed to be employment.

. . .

"For purposes of this section, a 'pay period' is the period (of not more than 31 consecutive calendar days) for which a payment of remuneration is ordinarily made to the employee by the person employing him. Thus, if the periods for which payments of remuneration are made to the employee by such person are of uniform duration, each such period constitutes a 'pay period.' If, however, the periods occasionally vary in duration, the 'pay period' is the period for which a payment of remuneration is ordinarily made to the employee by such person, even though that period does not coincide with the actual period for which a particular payment of remuneration is made. For example, if a person ordinarily pays a particular employee for each calendar week at the end of the week, but the employee receives a payment in the middle of the week for the portion of the week already elapsed and receives the remainder at the end of the week, the 'pay period' is still the calendar week; or if, instead, that employee is sent on a trip by such person and receives at the end of the third week a single remuneration payment for three weeks' services, the 'pay period' is still the calendar week.

"If there is only one period (and such period does not exceed 31 consecutive calendar days) for which a payment of remuneration is made to the employee by the person employing him, such period is deemed to be a 'pay period' for purposes of this section.

"The rules set forth in this section do not apply (1) with respect to any services performed by the employee for the person employing him if the periods for which such person makes payments of remuneration to the employee vary to the extent that there is no period 'for which a payment of remuneration is ordinarily made to the employee,' or (2) with respect to any services performed by the employee for the person employing him if the period for which a payment of remuneration is ordinarily made to the employee by such person exceeds 31 consecutive calendar days . . ."

It is particularly to be noted from the foregoing section 1426(c) of the act and the second paragraph of section 402.207 of the regulations, that if one-half or more of the employee's time in the employ of a particular cooperative association in a pay period (as defined above) is spent in performing services which constitute

employment, then all the services of that employee for that association in that pay period shall be deemed to be employment.

Subsections (d) and (f) of section 1426 of the act state:

"(d) Employee. -- The term 'employee' includes an officer of a corporation.

"(f) Person. -- The term 'person' means an individual, a trust or estate, a partnership, or a corporation."

The Internal Revenue Code, section 3797(a), states that the term "corporation" includes associations.

Inasmuch as the old-age benefit tax, imposed by section 1410 of the act, fixes the amount as equal to specified percentages of the wages paid with respect to employment, it is of importance to note also the definition of "wages" as contained in subsection (a) of section 1426 of the act, which is in part as follows:

"(a) Wages. -- The term 'wages' means all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash; except that such term shall not include --

(1) That part of the remuneration which, after remuneration equal to \$3,000 has been paid to an individual by an employer with respect to employment during any calendar year, is paid to such individual by such employer with respect to employment during such calendar year;

(2) . . .

(3) The payment by an employer (without deduction from the remuneration of the employee) (A) of the tax imposed upon an employee under section 1400 or (B) of any payment required from an employee under a State unemployment compensation law; or

(4) Dismissal payments which the employer is not legally required to make."

Concerning the foregoing, reference is made to sections 402.227 and 402.228 of the regulations for comments and explanation by the Commissioner of "wages" and "exclusions from wages." Section 402.227 contains the following paragraph:

"The medium in which the remuneration is paid is also immaterial. It may be paid in cash or in something other than cash, as for example, goods, lodging, food, or clothing. Remuneration paid in items other than cash shall be computed on the basis of the fair value of such items at the time of payment."

The amount of the excise tax for old-age benefits, imposed upon employers, is fixed by section 1410 of the act. Section 402.402 of the regulations sets forth the following tabulation:

"Sec. 402.402. Rates and computation of employers' tax. --
The rates of employers' tax applicable for the respective calendar years are as follows:

	Percent
For the calendar years 1940, 1941, and 1942.....	1
For the calendar years 1943, 1944, and 1945.....	2
For the calendar years 1946, 1947, and 1948.....	2½
For the calendar year 1949 and subsequent calendar years.....	3

The employers' tax is computed by applying to the wages paid by the employer the rate in effect at the time such wages are paid."

The amount of the income tax for old-age benefits, imposed upon employees, is fixed by section 1400 of the act, and is incidentally equal to the excise tax imposed upon the employer. Section 1401 of the act requires that the income tax imposed upon every employee "shall be collected by the employer . . . , by deducting the amount of the tax from the wages as and when paid."

It appears, in conclusion, that cooperative associations are liable for payment of the tax imposed by section 1410 of the act with respect to the services performed by their employees, except as to all or portions of the services performed by individual employees if such services either do not constitute employment [section 1426(b)], or are deemed not to be employment [section 1426(c)]. In ascertaining the exceptions, the following outline of pertinent inquiries may prove helpful:

- I. Can it be determined that all or a portion of the service performed by a particular employee does not constitute employment?
 - A. Is the service within the statutory definition of agricultural labor?
 1. Is the service performed "in connection with" the ginning of cotton? or the hatching of poultry? or the raising or harvesting of mushrooms? or the operation or maintenance of ditches, canals, reservoirs, or waterways used exclusively for supplying or storing water for farming purposes? or the production or harvesting of maple sap or the processing of maple sap into maple sirup or sugar (but not the subsequent blending or other processing of such sirup or sugar with other products)? or the production or harvesting of crude gum (oleoresin) from a

living tree or the processing of such crude gum into gum spirits of turpentine and gum rosin, provided such processing is carried on by the original producer of such crude gum?

2. Is the service performed "in" the actual handling, processing, etc., of agricultural or horticultural commodities, other than fruits or vegetables? and is such service performed "as an incident to ordinary farming operations"?
 - a. Have such commodities been produced by members of the cooperative association? and is such service of the character ordinarily performed by the employees of a farmer or of a cooperative association as a prerequisite to the marketing, in their unmanufactured state, of such commodities?
 - b. Such service may not be performed in connection with commercial canning or commercial freezing, and may not be performed in connection with any commodity after its delivery to a terminal market for distribution for consumption.
 - c. Services of stenographers, bookkeepers, clerks, and other office employees are not performed "in" the actual handling, processing, etc., of such commodities, even though such services may be "in connection with" such activities.
3. Is the service performed "in" the actual handling, processing, etc., of fruits and vegetables? and is such service performed "as an incident to the preparation of such fruits or vegetables for market"?
 - a. If so, such fruits and vegetables need not be the fruits and vegetables of members.
 - b. Such service may not be performed in connection with commercial canning or commercial freezing, and may not be performed in connection with any commodity after its delivery to a terminal market for distribution for consumption.
 - c. Services of stenographers, bookkeepers, clerks, and other office employees are not performed "in" the actual handling, processing, etc., of such fruits and vegetables, even though such services may be "in connection with" such activities.

B. During any calendar quarter, is the cooperative association for which the services are performed exempt from payment of

Federal income tax under subsection (12) or (13) of section 101 of the Internal Revenue Code? and

1. Is the remuneration for such service during that quarter \$45 or less? or
2. Is such service during that quarter performed by a student who is enrolled and is regularly attending classes at a school, college, or university?
 - a. The type of service and the amount of remuneration are immaterial.

II. If some of the service performed by a particular employee during any pay period constitutes employment, can it nevertheless be determined that all of the service of such employee during such pay period is deemed not to be employment?

- A. Is less than one-half of the employee's time in the employ of the association during such pay period spent in performing services which constitute employment?
- B. A "pay period" is the period (of not more than 31 consecutive calendar days) for which a payment of remuneration is ordinarily made to the employee by the cooperative association.

* * *

It may be noted incidentally that the act also states in subsection (b) of section 1426:

"(b) Employment. -- The term 'employment' means . . . any service, . . . performed . . . by an employee for the person employing him, . . . except --

. . .

(10)

. . .

(B) Service performed in the employ of an agricultural or horticultural organization exempt from income tax under section 101(1)."

The foregoing relates solely to agricultural or horticultural organizations -- not cooperative associations -- which are exempt from the payment of Federal income taxes under subsection (1) of section 101 of the Internal Revenue Code. Concerning this provision of the act, section 402.213 of the regulations has the following to say:

"Sec. 402.218: Agricultural and horticultural organizations exempt from income tax. -- Services performed by an employee in the employ of an agricultural or horticultural organization exempt from income tax under section 101(1) of the Internal Revenue Code are excepted.

"For purposes of this exception, the type of services performed by the employee, the amount of remuneration for such services, and the place where such services are performed are immaterial; the statutory test is the character of the organization in whose employ the services are performed."

NO EXEMPTION FROM FEDERAL INCOME TAXES UNLESS PROPERLY ORGANIZED

The opinion of the Board of Tax Appeals in the case of Council Bluffs Grape Growers Association v. Commissioner of Internal Revenue, ⁴⁴ B.T.A. ____, is here given in full:

"The respondent determined deficiencies in income tax for the years 1934 and 1935 in the respective amounts of \$488.02 and \$388.02, and excess profits taxes for the same years in the respective amounts of \$177.46 and \$117.97. The only issue is whether the petitioner is exempt from tax as a farmers' or fruit growers' co-operative marketing association within the meaning of section 101 (12) of the Revenue Act of 1934.

"The case was submitted upon a written stipulation of facts and the facts as stipulated constitute our findings herein.

"The Council Bluffs Grape Growers Association was organized as a corporation under chapter 390, Code of Iowa 1924, and ever since its incorporation in 1927 has had its principal place of business in Council Bluffs, Iowa. It was organized for the purpose of handling upon a commission basis fruits and products of its members and to buy, sell, and handle other commodities which may be incidental and necessary to the proper conduct of its business. Persons engaged in the production of the products or in the use or consumption of the supplies handled by or through the petitioner, including the lessors and landlords of lands used for the production of such products who receive as rent part of the crop raised on the leased premises, may become members of the petitioner association.

"Under petitioner's bylaws, which were adopted in April 1927 and were in effect during the taxable years 1934 and 1935, the manager of the association was authorized to receive and ship fruits for nonmembers. The bylaws provide that 'The Association shall charge 10 percent for selling produce

handled by it and such additional charge for ice and handling as the Board of Directors may deem necessary, equitable and just with the exception of apples or pears in carload lots, then 5 percent selling charge will be made. When 5 percent is charged those particular fruits do not enter into refund.' The bylaws also provide that the refund which would ordinarily be paid to members of the association 'shall be withheld for a period of five years beginning in 1927 and such refund for such periods shall be used to build up a cash reserve for the association to aid and assist in the proper conduct and carrying on of its business. . . . At the annual meeting of the association in January after the expiration of said five years, and at each annual meeting thereafter a refund may be ordered paid to the membership on the basis of the amount that such members would have coming for the fifth year previous to the ordering of the paying of the refund.'

"Since the adoption of its articles of association the petitioner's business has been conducted generally on a cooperative basis. The association has no capital stock, but in lieu thereof issues memberships to growers, who are required to pay a fee of \$10 and annual dues of \$1. All memberships are held by producers.

"The petitioner transacts business for both member and nonmember patrons. 'Nonmember growers were not entitled to share in the corporate profits in 1934 and 1935. The earnings of petitioner in the amount of \$3,250.04 in 1934 and \$902.80 in 1935 were set up on the petitioner's books as an accrued liability to member growers' refund account and the member growers were issued unpaid refund certificates in accordance with the bylaws then in effect.'

" 'In 1935 the above amounts, totaling \$4,152.84, were credited to working capital reserve which is shown on the petitioner's books and income tax returns for 1934 and 1935 as "net worth" account, from unpaid refund certificates. No patronage dividends were paid in cash to either member or nonmember patrons for the years 1934 and 1935.'

" 'The petitioner only transacted business with producers during the years 1934 and 1935, and during said years about 5 percent of the gross business of petitioner was transacted with nonmember growers. No patronage dividend credit was made to nonmembers which might enable them to receive their proportionate share of profits for 1934 and 1935 upon becoming members.'

"The main crop handled by petitioner consisted of grapes, which, prior to the agricultural depression, petitioner was able to market when packed in baskets. Since about 1933 petitioner

has been able to market only a portion of the grapes so packed. Upon the repeal of national prohibition it began marketing the balance of the grapes by making them into wine. A Federal permit as a winery was granted to petitioner in 1933 and in that and subsequent years it became necessary for it 'to expend large sums of capital for wine-making equipment and large funds were required in order to age the wine for three years before it could be marketed.'

"On September 4, 1937, the petitioner amended its bylaws to permit nonmember patrons to participate or share in patronage dividends equally on the same basis as members.

"The petitioner filed income tax returns for the years 1934 and 1935 in which it claimed exemption from the tax. The respondent denied the exemption, made certain adjustments in net income, and determined the deficiencies shown above.

"In support of its contention that it has qualified as an exempt cooperative marketing association within the meaning of the act, the petitioner asserts on brief that during the years 1934 and 1935 the members and nonmembers of the association were 'treated equally.' It also contends that the exemption should not be denied since the business transacted with nonmembers was 'negligible.' The respondent contends that, since the nonmembers neither shared nor were entitled to share in the profits of the association during the taxable years, it did not qualify as a corporation exempt from tax.

"Section 101 (12) of the Revenue Act of 1934 of the statute provides that 'farmers', fruit growers', or like associations organized and operated on a cooperative basis (a) for the purpose of marketing the products of members or other producers, and turning back to "them" the proceeds of sales, less necessary expenses, on the basis of either the quantity or the value of the products furnished by them' shall be exempt from taxation. Obviously the petitioner does not qualify under the provisions of the statute quoted. Not only was it not organized for the purpose of turning back to nonmembers the proceeds from the sale of products sold for them less the necessary marketing expenses, but it did not actually turn back to nonmembers any part of such proceeds, and under its bylaws nonmembers had no right to such rebates. The petitioner argues, however, that members and nonmembers were in fact 'treated equally' in that no rebates were made to either members or nonmembers 'for the years 1934 and 1935.' It further argues that the failure to make rebates was due to the accumulation of a reasonable reserve which was necessary to meet the changing conditions in the grape-growing industry resulting from the depression, and that the statute specifically provides that exemption shall

not be denied to any such association 'because there is accumulated and maintained by it . . . a reasonable reserve for any necessary purpose.' In making the above argument the petitioner ignores the plain language and spirit of the statute. Congress has stated in clause (a) that in order to be entitled to exemption the association must be organized and operated 'for the purpose of marketing the products' of its patrons, nonmembers as well as members, 'and turning back to them the proceeds of sales, less necessary marketing expenses.' Clearly there was no purpose or intent in the organization of the petitioner to turn back to nonmembers at any time any part of the proceeds from the sale of their products, and the clause to the effect that exemption shall not be denied because of the accumulation of a reasonable reserve for any necessary purpose in no way relaxes the requirement under clause (a). To be entitled to exempt status not only must an association meet the statutory test as to purpose of organization, but it must be organized in such manner as to require the carrying out of that purpose. The petitioner here was not so organized. See Regulations 86, art. 101 (12) 1; Farmers Mutual Cooperative Creamery of Sioux Center, Iowa, 33 B.T.A. 117; Producers Creamery Co. v. United States, 55 Fed. (2d) 104; Fruit Growers Supply Co., 21 B.T.A. 315; affd., 56 Fed. (2d) 90; and Farmers Union Co-operative Oil Co., Nelson, Nebraska, 38 B.T.A. 64. With further respect to the petitioner's argument that members and nonmembers were 'treated equally' in that no patronage dividends were paid to either member or nonmember patrons 'for the years 1934 and 1935,' there is some question whether the record would support such a conclusion. According to the bylaws, the profits for any particular year could not be rebated even to members until the fifth succeeding year, and during the taxable years before us, 1934 and 1935, the only rebates permitted by the bylaws would have been from the profits realized for the years 1929 and 1930. The record is silent as to whether or not rebates were made in 1934 and 1935 for the years mentioned and, as we have already pointed out, no rebate could have been made to nonmembers under any circumstances, the bylaws not having been changed until 1937 to allow nonmembers to participate.

"The respondent's determination that petitioner is not an exempt organization is sustained." [Underscoring added.]

ACCOUNTS RECEIVABLE OF MILK ASSOCIATION HELD TAXABLE

A cooperative milk association was engaged in selling milk produced by its members to milk distributors in the District of Columbia. Accounts receivable arising from sales of such milk were held taxable as property of the association under a District of Columbia tax statute, which provided that:

"The moneys and credits, including moneys loaned and invested, bonds and shares of stock...of any person, firm, association, or corporation resident or engaged in business within said District shall be scheduled and appraised in the manner provided by section 753 of this title for listing and appraisal of tangible personal property...."

The Court found that:

"Petitioner is a nonstock cooperative membership corporation. It is incorporated under the laws of Maryland and licensed under the cooperative marketing law of Virginia. Its members are some 1150 dairy farmers (producers), none of whom lives in the District of Columbia. It sells, to distributors, substantially all the milk which its members produce. It makes contracts with distributors by which they agree to buy milk from it. The members deliver the milk to the distributors as petitioner directs. The distributors make their payments to it. It makes price adjustments, deducts one cent per gallon, and turns over the residue to the members. The one cent deduction has exceeded petitioner's operating expenses. The excess has been set up as a reserve, invested in securities, and retained for six years as a 'revolving fund.' Each year payments are made from this fund, to those who were members during the sixth preceding year, substantially in proportion to the gallonage contributed by them, but subject to certain variations."

The association urged that it was acting as agent for its members in the sale of their milk and that the accounts receivable were in fact the property of its members. In refusing to adopt this view the Court said:

"Before 1935, payments for milk were made by the distributors to the producers, except one cent a gallon which was paid to petitioner. But during the years here in question, each distributor made his payments for milk not to the producers, but to the petitioner, on the 10th of each month, by a single check. About the 15th of each month, after deducting one cent a gallon and making other adjustments, petitioner made remittances to its members. On July 1st in each year, when tax liabilities became fixed, the distributors owed petitioner large amounts of money. These obligations have been assessed as its property. It claims that they did not belong to it but to its members, for whom it was a mere collecting agent."

"The distributors contracted that they would 'buy...from the Maryland and Virginia Milk Producers' Association, Inc.' and would pay 'directly to the Association.' The Association contracted to 'supply' the distributors, and to credit them for

pasteurized cream returned by them. Petitioner's contracts of sale to the distributors do not suggest that petitioner acted as an agent for the producers.

"Petitioner's contracts with the producers are somewhat ambiguous. They do not require the conclusion that petitioner was in fact an agent, though they do indicate that it may have thought itself an agent. The producers agreed to 'consign' their milk and cream to petitioner. Petitioner agreed to sell it and either to 'remit the proceeds thereof to the producer' or to 'authorize the purchaser....to pay direct to the Producer'; less deductions, which might exceed one cent per gallon, for expenses, interest, overhead, depreciation, obligations, and reserves; and subject to 'such fair and equitable differentials....as the Association may from time to time establish under uniform rules applicable to all other producers under like conditions all of which are hereby authorized, to the end that the price received by each producer in each Market Area and applicable thereto, which may differ one from another as prescribed by the Board of Directors from time to time, shall be substantially uniform with that received by all other producers for milk and/or cream of the same quality produced and marketed at the same time and place under substantially the same circumstances and conditions for the same Market Area.' Petitioner agreed to 'exercise its best efforts to sell at fair prices all the milk and/or cream produced by its members....and in event of inability to sell the same fluid milk or cream to convert same into other dairy products and dispose of same and collect the proceeds and distribute the net proceeds between the Producer and the other producer members of the Association in the same Market Area in the manner herein contemplated and provided for by the constitution and bylaws, rules and regulations of the Association....The Association guarantees ultimate payment to the Producer at standard prices prevailing for the time being for each Market Area for like milk and/or cream produced, delivered and sold under like circumstances and conditions.....for which such distributor or purchaser fails to pay....and guarantees the Producer against loss resulting through loss of market or failure of the Association to provide a market to the Producer for his output.' Thus the amounts which petitioner paid to particular producers had no uniform relation to the amounts which petitioner received from distributors for the milk furnished by the particular producers. If the distributor who received milk furnished by a particular producer failed to pay for it, the loss was shared by all members. The contracts provided for specific performance, as well as damages, at the suit of petitioner, against a defaulting producer.

"In the light of these facts we cannot say that the obligations of the distributors, which purported to belong to petitioner, really belonged not to it but to its individual members. In fact, it is hard to see what is meant by such a statement, for it is hard to see what incidents of ownership petitioner lacked or its individual members possessed. If it was only an agent, for whom was it an agent? The particular member whose milk went to a particular distributor had no greater economic interest than the other members in the sums which that distributor promised to pay the petitioner. As far as we can see, the particular member had no greater legal right than the other members in those sums. It follows that if the several obligations of the distributors were not owned by petitioner they must have been owned, not by the individual producers severally, but by all of them collectively. Such a view would treat the producers substantially as partners, ignoring the fact that the Association was not a partnership but an incorporated legal entity. It has been repeatedly held, in Maryland and elsewhere, that a cooperative corporation is an entity distinct from its members. We see no more reason for asserting that all petitioner's individual members owned these accounts than for asserting that all the individual shareholders of a stock corporation own its accounts. Even when a cooperative association's contracts with its milk-producing members have been phrased clearly in terms of agency, it has been conceded that title to the milk passed to the association, and held that the association, and not the member, was the actual seller of the milk which the distributors bought. We think the petitioner acted as a principal and owned the accounts receivable."

The question of whether the association was liable for a business privilege tax was also involved and in regard to this tax the Court held that:

"The tax on 'the privilege of engaging in business in the District of Columbia' for the fiscal year 1937-1938 was imposed in proportion to the 'gross receipts. . . derived from such business for the calendar year 1936; Provided, however, that the tax imposed by this section shall be payable only upon the gross commissions of any person engaged in the business of a broker or agent, and shall not be payable upon the funds of his principal, of which he is a mere conduit.' It follows from what has been said that petitioner was not engaged in the business of a broker or agent, was not a mere conduit for the funds of a principal, and was rightly assessed on the basis of its gross receipts."

Chief Justice Groner filed an opinion dissenting in part from the holding of the Court. He held that the association was acting as agent and that the accounts receivable were in fact the property of the members. In this connection he pointed out that:

"The plan of distribution to milk distributors was that the farmer delivered his entire production of milk daily, as directed by petitioner, to a particular distributor and the distributor would pay petitioner on the 10th day of each month for the milk received the preceding month. Petitioner in turn remitted to the farmer on the 15th of the month for the milk furnished by him, less the one cent per gallon commission. For the years 1935, 1936, and 1937, the aggregate of uncollected accounts shown by the books of petitioner as of July 1 of each of these years (the taxable period) for milk delivered to distributors, was \$1,153,923.51. Taxes amounting to \$5,769.62 were assessed on this amount on the theory that these receivables were taxable assets of petitioner. The opinion sustains this assessment. In my judgment, these items were not then and never were the property of petitioner, but actually belonged to the farmer members, less only the one cent per gallon which petitioner could retain for expenses and the accumulation of its protective fund. I am, therefore, of opinion the assessment was erroneous. The question in this aspect of the case turns, as I think, upon the relation between the producing farmers and petitioner.

"Did the farmer sell his milk to petitioner for resale, as to a merchant, or did he turn it over to petitioner for sale for his own account through the efforts of petitioner, as through a factor or broker?

"The main opinion answers the question on the theory that petitioner in its business relations with its farmer members in the distribution of their milk acted as principal and as such owned the accounts receivable. But the record wholly fails to support this conclusion. The fact that the Washington distributors of milk made their contracts with petitioner without any mention of agency is, I think, immaterial. It is a rule of commercial law that an agent may sell goods of his principal in his own name. *Slack v. Tucker & Co.*, 23 Wall, 321, 330; 22 Amer. Jur., Factors, Sec. 14. Although the relation between producers and association might not be strictly within the ancient category of factor, nevertheless, in view of all the circumstances, especially the written marketing agreement described below, I think the manner in which the business was transacted brings the relationship clearly within that rule. The case of *People v. Shoemaker*, 228 App. Div. 314, 239 N. Y. Supp. 71, affirmed per curiam 254 N. Y.

567, 173 N. E. 869, on which the majority rely, is not in point. That case involved a penalty on a man for not registering as a purchaser of milk from producers, and the point was whether purchase from a co-operative was purchase from a producer, within the meaning of this penal provision. The New York court held it was not, because the purchaser customarily bought from the co-operative and dealt directly with it. The question involving the relation of the purchaser and the property interests of producers and co-operative, respectively, did not enter the case, as in the present controversy.

"In fact, the court could hardly have decided otherwise. Here the proceeds of the milk sold by petitioner both at law and by the custom of the business belonged to member producers, and the producer was legally entitled to the proceeds of sale. *United States v. Villalonga*, 23 Wall. 35. This is particularly the case here, because the member and the co-operative agreed that all milk produced by all members might where necessary be commingled and sold and the sales price collected by petitioner and the net proceeds accounted for according to quantity and quality as ascertained by certain established classifications. In such circumstances, there was no change of title or ownership. 'The assignment would not in law transfer (title to) goods and merchandise entrusted to them, as factors, to sell.' *Chesterfield v. Dehon*, (Mass.) 16 Am. Dec. 367. Nor is the rule changed by reason of the fact that petitioner guaranteed payment to the member-producer. Such a guaranty made petitioner a *del credere* agent. The fact of guaranty proves the agency relationship, for there would be no point in petitioner's guaranteeing its own obligations. If petitioner was buying milk rather than acting as agent or factor for its members, the obligation to pay would have been its own and the guaranty would have been meaningless. The manner of operation or co-operation is more clearly disclosed in two instruments--petitioner's charter and the contract of membership. In neither is there any mention of title passing to petitioner. All members signed a 'standard marketing agreement,' in which the producer 'agrees to consign or to have consigned to the association in accordance with its instructions' all milk or cream produced on farms operated by him during the continuance of the contract. The word consign does not mean sell, but does have a definite commercial meaning. In *Sturm v. Boker*, 150 U. S. 312, 326, the Supreme Court said:

'It is too clear for discussion or the citation of authorities, that the contract was not a sale of the goods by the defendants to Sturm. The terms and conditions under which the goods were delivered to him import only a consignment. The words "consign" and "consigned"

employed in the letters were used in their commercial sense, which meant that the property was committed or entrusted to Sturm for care or sale, and did not by any express or fair implication mean the sale by the one or purchase by the other.'

"Here there is every indication that the word was used in the sense referred to in the Sturm case. The agreement clearly points to the relation of factor or agent. It provides that the association shall sell or dispose of the milk. If the milk belonged to it, there would be no reason or necessity for promising anything with regard to this disposal.

"The agreement provides not only that the petitioner shall sell, but shall sell milk consigned to it and shall remit the proceeds to the member on the 15th day of each month, less only the agreed commission. It clearly creates a del credere agency, and the proceeds of sales, in the form of accounts collectible on July 1, being the money of the producer as owner of the milk, is not property of petitioner and is therefore not taxable as intangible assets of petitioner. And for the same reason the gross proceeds of all milk sold for members in the year in question is not the basis on which taxes for license purposes may be assessed as 'gross proceeds of operation.' And this is obvious from the language of the business privilege tax section,* in which it is expressly provided that the license tax shall be computed and be payable only, in the case of a broker or agent, upon gross commissions and shall not be taxable or payable upon funds of the principal of which the agent is the mere conduit. Here, if I am correct, the milk never having belonged to petitioner, its sale by petitioner with the obligation to pay the proceeds to the producer made it a 'mere conduit' as to the sum so transmitted by it.

"I am, therefore, of opinion that so much of the decision of the Board of Tax Appeals as found petitioner liable for taxes on account of receivables from dealers and so much as imposed taxes under the Business Privilege Tax Act on the entire gross proceeds of farmer-milk sold by petitioner in the year 1938, is erroneous and should be set aside and annulled."

"*Sec. 970 (5), Title 20, D. C. Code, Supp. III, in force at the time: Provided, however, that the tax imposed by this section shall be payable only upon the gross commissions of any person engaged in the business of a broker or agent, and shall not be payable upon the funds of his principal, of which he is a mere conduit."

Maryland and Virginia Milk Producers' Association v. District of
Columbia, _____ F. 2d _____

In general, it will be remembered that the Courts have, even in cases involving marketing contracts which specified that the association bought and the members sold, been inclined to hold that the actual relation between the association and its members in effect was that of principal and agent. See Texas Farm Bureau Cotton Association v. Stovall, 113 Texas 273, 253 S. W. 1101; Texas Certified Cottonseed Breeders Association v. Aldridge, 122 Texas 464, 61 S. W. 2d 79; Colorado-New Mexico Wool Marketing Association v. Manning, 96 Colorado 186, 40 P. 2d 972; City of Owensboro v. Dark Tobacco Growers' Association, 222 Kentucky 164, 300 S. W. 350; Kansas Wheat Growers' Association v. Board of Commissioners of Sedgwick County, 119 Kansas 877, 241 P. 466. See also: Haarparinne v. Butter Hill Fruit Growers' Association, 122 Maine 138, 119 A. 116.

A cooperative association functions as a marketing medium for its members and contracts to pay its members what it receives for their products after making authorized deductions. Obviously, an association functioning in this manner is not attempting to buy low and sell high, but simply to perform a marketing service for its members.

It has been held that where an association was functioning on an agency basis the proceeds of sales made by an association for its members were not subject to attachment as property of the association. Lambert v. Military Ridge Cheese Company, 179 Wisconsin 359, 191 N. W. 555; First National Bank of Elgin v. Kilbourne, 127 Illinois 573, 20 N. E. 681. See also: Filiatreau v. United States, 14 F. 2d 659; National Bank v. Insurance Company, 104 U. S. 54, 26 L. Ed. 693, 23 C. J. 352; Funds Received for Commodities Handled on Agency Basis not Subject to Garnishment, Summary No. 9, page 1, Summary of Cases relating to Farmers' Cooperative Associations.

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